1977

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COLONIAL OIL & GAS LIMITED

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Annual Report

COLONIAL OIL AND GAS LIMITED and SUBSIDIARIES

COG Inc.
Fort Nelson Gas Ltd.
Fort Nelson Transmission Co. Ltd.
General Utilities Corporation Ltd.
West Ridge Resources Ltd.
West Ridge Resources Inc.

DIRECTORS:

R. JAMES BALFOUR, Q.C.
Member of Parliament, Ottawa, Ontario

JOHN L. GIBSON
Chairman, Highmont Mines Ltd., Vancouver, B.C.

ROBERT W. HOLE
President, Lockerbie & Hole Ltd., Vancouver, B.C.

HARVEY A. McDIARMID
President, National Homes Ltd., Vancouver, B.C.

JOHN B. ROSS
President, Burrard Mortgage Investments Ltd., Vancouver, B.C.

FRANK J. SIMINGTON
President, General Utilities Ltd., Vancouver, B.C.

NICOLAAS M. VAN DRIMMELEN
President, Netherlands Acceptance, Vancouver, B.C.

OFFICERS:

HARVEY A. McDIARMID — *President*
ROBERT W. HOLE — *Vice-President*
FRED W. MAYCOCK — *Secretary*

REGISTERED OFFICE:

1600 - 1177 W. Hastings Street
Vancouver, British Columbia V6E 2L2, Canada

ADMINISTRATION OFFICE:

1300 - 100 W. Pender Street
Vancouver, British Columbia V6B 1R8, Canada
Telephone (604) 685-9821

BANKERS:

ROYAL BANK OF CANADA
1025 W. Georgia Street
Vancouver, British Columbia V6E 3N9, Canada

REGISTRAR AND TRANSFER AGENT:

MONTREAL TRUST COMPANY
Vancouver and Regina, Canada

AUDITORS:

DELOITTE, HASKINS & SELLS
1500 - 1055 W. Georgia Street
Vancouver, British Columbia, Canada

STOCK LISTING:

VANCOUVER STOCK EXCHANGE

Report of the President on behalf of the Directors to the Members

FINANCIAL:

The year 1977 has been the most successful in the history of the Company. Cash flow of $383,289.00 was nearly double the 1976 figure of $196,901.00, while the net profit was 7 times that of the prior year. Oil and natural gas revenues before Royalty payments jumped from six hundred and twenty-four thousand dollars to slightly over one million dollars. Royalty payments of two hundred and sixty-six thousand dollars were more than double those of the prior year.

Sales by the operating utility company, Fort Nelson Gas Ltd. were up 15%, primarily due to higher producer gas prices which were permitted to be passed through to the customers.

Operating and administrative costs were held to an increase of 15% for the year, which is encouraging when you consider that sales increased 60% over the prior year. A significant write-off amounting to two hundred and thirty-eight thousand dollars Canadian Funds ($224,248.00 U.S. Funds) resulted from the abandonment of the Anse La Butte well in Louisiana, a 10,000 foot test in which the subsidiary West Ridge Resources Inc. had a 25% working interest. Under U.S. accounting practice known as "successful venture accounting" abandoned wells must be written off immediately, whereas most small oil and gas companies would prefer to use "full cost" accounting, spreading the write-off over a period of time, as is currently permitted in Canada.

1977 OIL AND GAS PRODUCTION

During 1977 Colonial Oil and Gas Ltd. produced 13,331 barrels of Oil, of which all but 300 barrels were produced in Saskatchewan. The average daily production was 36.5 barrels.

Colonial and the subsidiaries produced 776,328,000 cubic feet of gas during the year, of which 270,000,000 cubic feet were from the Bullhook Unit in Montana, the rest being produced in Alberta and Saskatchewan.

The average daily production was 2,127,000 cubic feet.

Fort Nelson Gas Ltd. sold during the year a total of 467,023,000 cubic feet of gas in Fort Nelson and vicinity. This averaged 1,279,000 cubic feet per day.

EXPLORATION AND DEVELOPMENT DRILLING:

During 1977 the Company and subsidiaries participated in the drilling of 11 wells, 6 in Alberta, 4 in Montana and 1 in Louisiana. Of these, 1 is a producing oil well, 4 are gas wells, 1 is still being tested for oil, and 5 were abandoned. A further 8 wells scheduled for drilling in November and December in Montana were postponed when severe cold and drifting snow made the movement of drilling equipment impossible. These will be drilled after break-up this spring.

FORT NELSON GAS LTD.

All areas of operation throughout the Company and the subsidiaries showed increasingly profitable operations, with the exception of Fort Nelson Gas Ltd. Strenuous efforts have been made to increase the permissable rate of return on this wholly owned Utility. An application for a rate increase was filed with the B.C. Energy Commission prior to the end of 1977. The Company was granted an interim increase of 30¢ per MCF effective 1 Feb. 1978 and a full hearing is scheduled for July 11th and 12th in Fort Nelson, B.C. This subsidiary had an operating loss in 1977, and to realize an adequate rate of return its rate base will require a further more substantial increase than that granted in February. Growth in the town of Fort Nelson is being held up by the indecision on the part of the Goverment of British Columbia over the adviseability of abandoning the B.C. Rail branch line. Oil and gas exploration activity in the area over the winter of 1977 - 78 was greater than for many years, and the prospect of the Alaska-Canada gas pipeline will contribute to the growth of Fort Nelson which is strategically located to be a major supply and transportation hub for this multi-billion dollar project. It would seem illogical to abandon this rail line when everything points to years of growth ahead for this part of our country.

GAS CONTRACTS

A definite gas surplus is developing in Alberta, but we have not yet been asked to cut back on our contract volumes. We do have interests in several wells in the Red Willow-Donalda area of Alberta for which we do not yet have contracts.

BULLHOOK UNIT – MONTANA

The gas pricing policy in the United States is still very much up in the air, and although our average price received for both new and old gas is now in the range of 95¢ per MCF, up from 53¢ a year ago, this is still only equivalent to $6.00 a barrel for oil. Although total deregulation of gas prices will probably never happen, suggested new gas prices of $1.75 per MCF, while still .55¢ per MCF under Canadian Border prices, would undoubtedly result in significant development and exploratory drilling. It is estimated that 150 more wells will be needed to fully produce the potential reserves in the Bullhook field alone. In light of current drilling costs, it is unreasonable to expect many of these wells to be drilled for 95¢ gas.

SASKATCHEWAN

The decline in oil production from the Lucky Hills Unit and the Avon Hills wells in Saskatchewan was offset by the full year's production from the Midale well drilled in July 1976. Increased oil prices have made operating in Saskatchewan more attractive, and the Government of Saskatchewan is understood to be contemplating an increase in gas prices, particularly for wells producing both oil and gas.

OFFSHORE - GERMAN, NORTH SEA AND WEST COAST AFRICA

Colonial has maintained a 16% working interest in the J2 Block of the German Sector. Some recent drilling has been done in this sector, and more wells are expected to be drilled this summer. So far no results are known, however re-interpretation of seismic done earlier on the J2 indicates a possible Rotliegend structure. A similar structure is productive in the Dutch sector.

Political unrest in Namibia, formerly South West Africa, has limited exploration efforts on an off-shore block near Walvern Bay in which Colonial has a minor interest.

1978 FIRST QUARTER RESULTS

First quarter results, unaudited, for the period ending Mar. 31, 1978 are up substantially over the same period of a year ago, and show solid continuation of the profitable trend evident through most of 1977. Revenue for the period was $657,560.00 compared to $565,752.00 in 1977, and cash flow of $228,885.00 is up 102% over the amount of $113,528.00 in 1977.

On behalf of the Board
Harvey A. McDiarmid
President.

April 15, 1978

AUDITOR'S REPORT

To the Shareholders of
Colonial Oil & Gas Limited:

We have examined the consolidated balance sheet of Colonial Oil & Gas Limited as at December 31, 1977 and the consolidated statements of income and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

DELOITTE, HASKINS & SELLS
Auditors

March 30th, 1978

COLONIAL OIL & GAS LIMITED

(Under the Companies Act, British Columbia)

CONSOLIDATED BALANCE SHEET AS AT DECEMBER 31, 1977

(with prior year's figures for comparison)

ASSETS

	1977	1976
CURRENT ASSETS:		
Cash	$ 100,249	$ 89,645
Accounts receivable	273,300	278,013
Inventories of supplies — at specific cost	41,272	42,672
Prepaid expenses	2,451	4,384
Total current assets	417,272	414,714
PROPERTY, PLANT AND EQUIPMENT (Note 2)	$ 4,137,348	3,926,417
OTHER ASSETS:		
Incorporation and organization costs	12,132	12,132
Financing costs — less amounts amortized	109,134	53,798
Deposits	27,500	27,500
Goodwill — at cost	76,535	76,535
Total other assets	225,301	169,965
TOTAL	$ 4,779,921	$ 4,511,096

LIABILITIES AND SHAREHOLDERS' EQUITY

	1977	1976
CURRENT LIABILITIES:		
Bank indebtedness (Note 3)	$ 150,000	$ 278,048
Accounts payable and accrued liabilities	401,694	285,297
Security deposits	44,888	26,534
Current portion of long-term debt	144,500	119,500
Total current liabilities	741,082	709,379
LONG-TERM DEBT (Note 4)	1,542,000	1,471,500
ADVANCES ON FUTURE GAS SALES (Note 5)	294,170	394,664
DEFERRED INCOME TAXES	145,296	116,171
SHAREHOLDERS' EQUITY:		
Share capital:		
Authorized — 5,000,000 common shares of no par value		
Issued and fully paid — 3,264,556 shares (Note 6)	2,707,369	2,486,969
Deficit	(649,996)	(667,587)
Net shareholders' equity	2,057,373	1,819,382
TOTAL	$ 4,779,921	$ 4,511,096

Approved by the Board:

F. J. SIMINGTON, Director
HARVEY A. McDIARMID, Director

The accompanying notes are an intergal part of the consolidated financial statements.

COLONIAL OIL & GAS LIMITED

CONSOLIDATED STATEMENT OF INCOME AND DEFICIT

FOR THE YEAR ENDED DECEMBER 31, 1977

(with prior year's figures for comparison)

	1977	1976
SALES:		
Oil and gas	$ 1,002,075	$ 624,092
Less royalties	266,353	131,565
	735,722	492,527
Gas distribution	586,464	508,998
Total Sales	1,322,186	1,001,525
COSTS AND EXPENSES BEFORE OTHER CHARGES:		
Operating — oil and gas	116,604	89,106
— gas distribution	335,237	232,723
Interest — long-term debt	166,783	146,085
— other	16,922	66,980
Salaries and employee benefits	142,296	143,847
Professional and consulting fees	28,182	43,944
Other general and administrative	117,442	81,939
Total costs and expenses before other charges	923,466	804,624
INCOME FROM OPERATIONS BEFORE OTHER CHARGES	398,720	196,901
OTHER CHARGES (CREDITS):		
Depletion	104,944	71,624
Depreciation	63,788	62,610
Gain on disposal of property and equipment	(26,939)	—
Amortization of financing costs	8,272	17,268
Cost of abandoned properties	238,488	16,113
Loss on foreign exchange	4,181	—
Net other charges	392,734	167,615
INCOME BEFORE INCOME TAXES AND EXTRAORDINARY ITEM	5,986	29,286
PROVISION FOR INCOME TAXES (Note 7):		
Current	17,033	6,150
Deferred	20,700	26,787
Total provision for income taxes	37,733	32,937
LOSS BEFORE EXTRAORDINARY ITEM	31,747	3,651
EXTRAORDINARY ITEM:		
Tax reduction resulting from application of prior years' tax losses (Note 7)	49,338	6,150
NET INCOME FOR THE YEAR	17,591	2,499
DEFICIT AT THE BEGINNING OF THE YEAR	667,587	670,086
DEFICIT AT END OF THE YEAR	$ 649,996	$ 667.587
INCOME PER SHARE (Note 8)		

The accompanying notes are an intergal part of the consolidated financial statements.

COLONIAL OIL & GAS LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED DECEMBER 31, 1977
(with prior year's figures for comparison)

	1977	1976
WORKING CAPITAL PROVIDED:		
Generated from operations	$ 383,289	$ 196,901
Extraordinary item — reduction in income taxes	49,338	—
Proceeds from disposal of properties and equipment	29,969	7,343
Contributions — natural gas consumers and others	13,727	11,894
Long-term debt	1,400,000	—
Alberta Royalty Tax Credit	42,067	—
Issue of shares	220,400	—
Bank loans	—	548,000
Reduction in current portion of bank loans	—	376,750
TOTAL	2,138,790	1,140,888
WORKING CAPITAL APPLIED:		
Paid or payable on long-term debt	170,750	273,250
Additions to petroleum and natural gas properties	541,922	101,176
Additions to plant and equipment	95,685	138,770
Repayment of advance on future gas sales	100,494	80,507
Financing charges	74,084	5,150
Repayment of bank loan	1,185,000	—
TOTAL	2,167,935	598,853
INCREASE (DECREASE) IN WORKING CAPITAL DEFICIENCY FOR THE YEAR	29,145	(542,035)
WORKING CAPITAL DEFICIENCY AT BEGINNING OF THE YEAR	294,665	836,700
WORKING CAPITAL DEFICIENCY AT END OF THE YEAR	$ 323,810	$ 294,665

The accompanying notes are an intergal part of the consolidated financial statements.

COLONIAL OIL & GAS LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1977

1. SIGNIFICANT ACCOUNTING POLICIES:

Consolidation:

The consolidated financial statements include the accounts of the company and the following subsidiaries, all of which are wholly owned:

- COG, Inc.
- General Utilities Corporation Limited and its wholly-owned subsidiaries, Fort Nelson Gas Ltd and Fort Nelson Transmission Co. Ltd.
- West Ridge Resources Ltd. and its wholly-owned subsidiary, West Ridge Resources Inc.

The excess of the purchase price of the shares of certain acquired subsidiaries over their net book values has been allocated to properties, plant and goodwill. The goodwill is not being amortized.

Foreign currency translation:

The accounts of two U.S. subsidiaries have been translated to Canadian dollars as follows:

- Current assets and current liabilities — at the rate of exchange prevailing at the year-end.
- Non-current assets — at the rate of exchange prevailing at the date of acquisition.
- Sales and expenses — at the average rate of exchange for the year.

Petroleum and natural gas properties and depletion:

All costs relative to the acquisition, exploration and development of oil and gas reserves are capitalized until such time as commercial production commences or the property is abandoned. Costs applicable to abandoned properties are charged to operations in the year of abandonment. Depletion of producing properties is provided for on the unit-of-production method based on the estimated recoverable reserves of oil and gas.

Depreciation and amortization:

Gas transmission and distribution facilities and other equipment are being depreciated on a straight-line basis at rates from 2% to 20% as prescribed by the British Columbia Energy Commission.

Gas and oil production equipment are being depreciated on the straight-line and declining-balance basis at rates from 10% to 30%.

Financing costs are being amortized over the term of the related long-term debt.

Deferred income taxes:

Deferred income taxes result primarily from deducting for tax purposes drilling, exploration and lease acquisition costs in excess of the related amounts provided in the accounts.

2. PROPERTY PLANT AND EQUIPMENT:

	1977	1976
Petroleum and natural gas properties at cost	$3,269,295	$2,959,296
Less accumulated depletion	357,029	252,086
	2,912,266	2,707,210
Gas and oil production equipment	310,539	264,286
Gas transmission and distribution facilities	1,278,765	1,247,456
Other	128,773	127,861
	1,718,077	1,639,603
Less contributions from natural gas consumers, in aid of construction	124,139	110,412
	1,593,938	1,529,191
Less accumulated depreciation	368,856	309,984
	1,225,082	1,219,207
	$4,137,348	$3,926,417

3. BANK INDEBTEDNESS:

	1977	1976
Colonial Oil & Gas Limited: Demand loan secured by shares of COG, Inc. (1976 — secured by a debenture with a specific second charge on gas interest owned by COG, Inc. and a floating charge on all the assets of the parent company)	$ 150,000	$ 115,000
Excess of cheques issued over cash on deposit	—	163,048
	$ 150,000	$ 278,048

4. LONG-TERM DEBT:

	1977	1976
11% debenture due 1989, repayable and secured as discussed below	$1,325,000	$ —
7% Series A first mortgage bonds due 1984, payable in annual instalments of $13,000 and secured by a charge on gas distribution facilities	91,000	104,000
9⅞% Series B first mortgage bonds due 1986, payable in annual instalments of $25,000 and secured by a charge on gas distribution facilities	225,000	250,000
7% Series A first mortgage bonds due 1978, payable in annual instalments of $6,500 and secured by a charge on gas transmission line	45,500	52,000
11¾% demand loan, secured by a floating charge on all the assets of the parent company and a specific second charge on the gas interest owned by a subsidiary	—	260,000
11¼% production loans, secured by an assignment of production proceeds from specific gas properties	—	925,000
	1,686,500	1,591,000
Less due within one year	144,500	119,500
Total long-term debt	$1,542,000	$1,471,500

The companies' new long-term financing consists of a debenture and mortgage given to The Great-West Life Assurance Company on a joint and several basis by Colonial Oil & Gas Limited and two of its wholly-owned subsidiories, (West Ridge Resources Ltd. and General Utilities Corporation Limited, and is secured by a first charge on the companies' interests in two specific petroleum and natural gas properties, by production equipment on the properties and by the assignment of production purchase agreements and net proceeds from sale of minerals from the pledged properties.

The debenture principal is repayable $25,000 quarterly commencing June 1977 to March 1981 and $31,250 quarterly from June1981 to March 1989.

The debenture agreement provides for the acceleration of principal repayments on the basis of increases in production revenues from the pledged properties.

Principal repayments on all long-term debt for the next five years are as follows:

1978	$144,500
1979	144,500
1980	144,500
1981	163,250
1982	169,500

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1977

(CONTINUED)

5. ADVANCES ON FUTURE GAS SALES:

These advances have been made under the terms of gas purchase agreements with two subsidiary companies. The advances are interest free and are repayable at the rate of 33⅓% of the sales value of gas delivered.

Amounts so repaid during the year totalled $100,494 (1976 - $80,507).

6. SHARE CAPITAL:

In February 1977, the company, by way of a private placement, issued 290,000 shares for cash of $220,400.

The company has granted options in respect of 200,000 shares to certain officers who are directors. The options may be exercised to acquire up to 25% of the shares annually, on a non-cumulative basis, until 1981 at a price of $.50 per share. During the year, options in respect of 200,000 shares were cancelled.

7. INCOME TAXES:

The provision for income taxes differs from the amount obtained by applying the Canadian corporation income tax rate to income before income taxes, primarily because of the effect of losses of certain of the companies on which deferred income taxes have not been provided. Any reductions in taxes payable will be recorded when the losses are utilized. The losses aggregate approximately $390,000 and expire as follows:

1978 - - - -	$ 61,000
1979 - - - -	20,000
1980 - - - -	37,000
1981 - - - -	62,000
1982 - - - -	210,000

As well, the company and certain subsidiaries have development and exploration expenditures amounting to approximately $2,600,000, which may be claimed on various basis as a deduction for tax purposes in future years.

8. INCOME (LOSS) PER SHARE:

Income (loss) per share, based on the weighted average number of shares outstanding during the year, was:

Loss before extraordinary item - -	(0.98)¢
Extraordinary item - - - - - -	1.52
Net income for the year - - - -	0.54¢

9. LEASE COMMITMENTS:

The company is committed under leases to 1981 for the rental of office premises and equipment as follows

1978 - - - -	$15,897
1979 - - - -	8,541
1980 - - - -	6,965
1981 - - - -	4,164

10. CONTINGENT LIABILITY:

Certain of the companies' gas sales prices, set by the United States Federal Power Commission, may be subject to rollback. If the Commission is required to reduce its established prices, the companies would be required to repay approximately U.S. $67,000.

11. SUBSEQUENT EVENT:

The company's wholly-owned subsidiary, Fort Nelson Gas Ltd., has obtained approval for a general interim rate increase of $.30 per MCF effective February 1, 1978. The company has applied for a formal hearing to confirm the increase in its rates.

12. REMUNERATION OF DIRECTORS AND SENIOR OFFICERS:

The aggregate direct remuneration paid or payable to directors and senior officers, as defined in the Companies Act, British Columbia, totalled $122,703 for the year, of which $117,903 was paid to full-time employees.